No. ____________.

Supreme Court of the United States

OCTOBER TERM, 1943.

C. E. MOTTAZ, I. C. SMITH, VIRGINIA BEHNKEN, WILLIAM H. MORGENS, AND CONTINENTAL COMPANY, A CORPORATION,
PETITIONERS,

VS.

EDWARD L. SCHEUFLER, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, GUSTAVE J. CRECELIUS, ANNA M. CRECELIUS AND MYRTLE K. CRECELIUS AND KANSAS CITY LIFE INSURANCE COMPANY, A CORPORATION,
RESPONDENTS.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINION OF THE COURT BELOW.

The opinion of the Supreme Court of Missouri is reported in 175 S. W. 2d 836 (not yet officially reported), and appears in the record at page 313.

STATEMENT AS TO JURISDICTION.

A statement of the basis on which this court has jurisdiction to grant the writ is set forth at pages 5 to 6 of the petition.

STATEMENT OF THE CASE.

For the purposes hereof petitioners rely upon the statement of the case on pages 2 to 5, inclusive, of the petition, filed herewith.

SPECIFICATIONS OF ERROR.

Petitioners submit that the Supreme Court of Missouri erred in the following particulars:

1. In failing to recognize these petitioners as *persons interested* in the assets of the dissolved Continental Life Insurance Company remaining after elimination of creditors and policyholders as persons interested therein although Sections 6058 and 6064 (Appendix) invested these petitioners with an interest in such assets.

2. In failing to apply the liquidation statutes of the Insurance Code of Missouri to determine the rights of petitioners to the fund in dispute.

3. In failing to determine whether the claims of creditors and policyholders of the dissolved Continental Life Insurance Company were discharged, satisfied and extinguished by the liquidation proceedings under the Insurance Code of Missouri.

4. In failing to construe the Missouri Insurance Code for liquidation of insurance companies as an insolvency law, proceedings under which extinguish and not merely stay claims.

5. In failing to determine, after reinsurance of policyholders and payment of other creditors' claims, that petitioners were the only remaining parties eligible under the statute as *interested persons* to receive the fund.

6. In failing to hold that by the voluntary surrender of their claims for money in exchange for reinsurance in another company, the policyholders eliminated themselves as creditors, thus disqualifying themselves as "*interested persons*" eligible to share in the fund.

7. In awarding the fund to Kansas City Life Insurance Company, when the contract of reinsurance expressly excepted said fund from assets of the dissolved company conveyed to said Kansas City Life Insurance Company, whereas under the code the fund belonged to these petitioners.

8. In awarding the fund to Kansas City Life Insurance Company for the stated benefit of policyholders whose claims had been satisfied by reinsurance, resulting in a windfall to said Kansas City Life Insurance Company at the expense of these petitioners to whom the fund belonged under the code.

SUMMARY OF ARGUMENT.

The failure of the Supreme Court of Missouri to give petitioners the fund in controversy, which belonged to them under the Missouri Insurance Code, has denied them the equal protection of the laws guaranteed them by the Fourteenth Amendment to the Constitution of the United States.

I.

The Missouri Insurance Code provides the exclusive method for winding up and liquidating the affairs of an insolvent insurance company.

II.

That Code, under which these proceedings were had, is an insolvency law, providing for the liquidation, settlement and winding up of the affairs of an insolvent insurance company, proceedings under which satisfy (not merely stay) the claims of all creditors (including policyholders).

III.

Under the Missouri law, when an insurance company becomes insolvent the holders of the policies become creditors to the extent of the cash surrender value and the unearned premiums of their policies.

IV.

Under the reinsurance contract in this case by which liquidation was effected the fund in controversy was expressly excepted from the assets transferred to the reinsuring company. Because it was so excepted and because the claims of policyholders and other creditors have been satisfied, petitioners (stockholders of Continental) constituted the only remaining *interested persons* invested by the code with an interest in the excepted asset, and the fund belonged to them.

V.

Even if the Missouri Insurance Code is not an insolvency law of such effect, the stockholders are entitled to the fund because:

A. On the declaration of insolvency of Continental, the policyholders ceased to be policyholders and claims on their policies were reduced to claims for money in the amount of the cash surrender values thereof and the unearned premiums.

B. Under the Code the Superintendent represents and acts for the policyholders in a proceeding to liquidate an insolvent insurance company. When therefore in the case at bar he effected reinsurance he elected for the policyholders to surrender their claims as creditors, for reinsurance in a solvent company.

C. Because the policyholders voluntarily surrendered their status as creditors they thereby disqualified themselves as *interested persons* under the code entitled to share in the remaining assets of the insolvent company, and the stockholders alone of the parties embraced by the code as *interested persons* remained qualified under the code to receive the fund.

VI.

The Supreme Court of the United States has jurisdiction to determine whether a state court has denied to rights asserted under local laws the protection which the United States Constitution guarantees, and this is true even though the state court bases its decision upon nonfederal grounds.

VII.

The protection of the 14th Amendment to the United States Constitution was invoked as soon as petitioners' rights under the local laws were first denied.

ARGUMENT.

That the Missouri Insurance Code is an exclusive Code regulating insurance business and insurance companies, including the dissolution and liquidation of such companies is not and cannot be disputed. *State ex rel.* v. *Hall*, 330 Mo. 1107, 52 S. W. 2d 174; *State ex rel.* v. *Dinwiddie*, 343 Mo. 592, 122 S. W. 2d 912; *McDonald* v. *Pacific States Life Insurance Company*, 344 Mo. 1, 124 S. W. 2d 1157.

This court has held that courts cannot disregard and nullify statutes by application of what they consider equitable principles. *U. S.* v. *Bethlehem Steel Corp.*, 315 U. S. 289, 86 L. Ed. 855. The Missouri Supreme Court has specifically held that equitable principles have been superseded by the Insurance Code and that cases arising under the Code must be decided according to that Code and not according to equitable principles. *Aetna* v. *O'Malley*, 343 Mo. 1232, 124 S. W. 2d 1164; *Aetna* v. *O'Malley*, 342 Mo. 800, 118 S. W. 2d 3. In the case at bar the Missouri Supreme Court denied the rights of these petitioners under the Missouri Insurance Code on the ground that to award petitioners the fund in dispute would be inequitable (R. 319).

The State of Missouri, acting through its Supreme Court, has thus denied petitioners their rights under statutes of that state and has thus denied them the equal protection of the laws. *In the Matter of the Commonwealth of Virginia, Petitioner*, 100 U. S. 313, 25 L. Ed. 667; *Norris* v. *Alabama*, 294 U. S. 587, 79 L. Ed. 1074.

II.

There are two kinds of insolvency laws. One merely operates to stay the remedy of creditors but does not

satisfy or wipe out the indebtedness. It is illustrated by the provisions of the Bankruptcy Act, as amended June 22, 1928 (11 U. S. C. A. 21 *et seq.*; 52 Stat. 844 *et seq.*). Under this type of insolvency law the remedy is merely stayed, but if such remedy is subsequently reinstated, the creditor can pursue his claim. (*Zavela* v. *Reeves*, 227 U. S. 625, 57 L. Ed. 676). The other type operates to fully satisfy and wipe out the claims of creditors. It is illustrated by Chapter X of the Bankruptcy Act which deals with corporate reorganizations (11 U. S. C. A. 501 *et seq.*, 52 Stat. 883). Under this Act, upon confirmation of a reorganization plan the creditors are bound thereby and the property of the debtor which is dealt with by the plan, or which remains in the hands of the debtor, is free from the claims of creditors (11 U. S. C. A., Sec. 626, 52 Stat. 898; *In Re 333 North Michigan Avenue Building Corp.*, 84 F. 2d 936, Cert. den. 299 U. S. 602, 81 L. Ed. 444). The Missouri Supreme Court has never construed the meaning and effect of the Missouri Insurance Code as an insolvency law and hence has never determined to which of the above classes it belongs.

The Missouri Insurance Code belongs to the latter class of insolvency acts because the declared purpose of that Code is to *liquidate, settle and wind up* the affairs of the company (Sec. 6059, Appendix) and administration of the company's assets and winding up of its affairs are provided for (Secs. 6062, 6064, Appendix; *International Shoe Co.* v. *Pinkus*, 278 U. S. 261, 73 L. Ed. 318; *In re Salmon & Salmon*, 143 Fed. 395; *In re Weedman Stave Co.*, 199 Fed. 948; *Straton* v. *New*, 283 U. S. 318, 75 L. Ed. 1060). When the word "liquidate" was added to the words "settle and wind up" in the Missouri Code (prior to the commencement of the present case), the word "liquidate" had been defined by the

Missouri Supreme Court to mean "to adjust; to reduce to precision in amount; to ascertain the balance due and to whom payable; to clear up; to pay and settle; *to satisfy*" (*State ex rel.* v. *Cantley*, 330 Mo. 943, 52 S. W. 2d 397). "To satisfy" means "to answer or discharge, as a claim, debt, legal demand, or the like; to give compensation for; to pay off; to requite; as, to satisfy a claim or an execution" (Webster's New International Dictionary).

Under this Code two methods of liquidation (and hence two methods of satisfying claims against the insolvent company) are provided. One method is for the Superintendent to sell the assets and distribute the proceeds *pro rata* to creditors according to their classification under the Code (Sec. 6062, Appendix). The other method is for the Superintendent to effect reinsurance with a solvent company upon the best terms obtainable for all *persons interested* (Sec. 6064, Appendix). By express provision of the Code, distribution of the assets to the creditors *pro rata* is not to be made when reinsurance is effected (Sec. 6062, Appendix). That is to say, if a contract of reinsurance is effected it completes the liquidation of the dissolved company, but if such reinsurance is not effected, then liquidation is accomplished by sale of the assets and distribution of the proceeds *pro rata* among the creditors according to classification (Sec. 6062, Appendix). The situation is comparable to a corporate reorganization proceeding under the Chandler Act, *supra*, wherein the confirmation of a plan of reorganization satisfies the claims of creditors. If any property of the debtor is not disposed of by the reorganization plan, it remains the property of the debtor free and clear of all claims of creditors. So in the case at bar, the method of liquidation under the Code by reinsurance was selected and con-

summated by the execution of a contract of reinsurance by the policyholders (acting through the Superintendent), and their claims as creditors of the insolvent company were thereby satisfied by their election to accept the plan. The fund in question, which was expressly excepted by the reinsurance contract from the assets conveyed to the reinsuring company, was an asset of the insolvent company. Any assets of the insolvent company which remained after such reinsurance continued to be the property of the company or those standing in its place (these petitioners) free and clear of all claims of the policyholders.

III.

Upon the dissolution of an insolvent life insurance company the liability on the policies of the company is terminated and the policyholders become creditors of the company for the cash surrender value and unearned premiums of their policies (*Lovell* v. *St. L. Mutual Life Insurance Co.*, 111 U. S. 264, 28 L. Ed. 423; *Carr* v. *Hamilton*, 129 U. S. 252, 32 L. Ed. 669; *Green* v. *American Life & Accident Co.*, 112 S. W. 2d 924 (Mo. App.).

IV.

By the contract of reinsurance, the fund in dispute was expressly excepted from the assets transferred to the reinsuring company, the Kansas City Life Insurance Company (R. 53).

Upon dissolution of the insolvent Continental Life Insurance Company title to said fund, along with that of all other assets, vested in the Superintendent for the benefit of the creditors and policyholders of said company "and *such other persons as may be interested in such assets*" (Sec. 6058, Appendix). We have established under Point II of this argument, that claims of policyholders

and other creditors were satisfied by the liquidation proceedings and therefore the Superintendent holds the fund "for the use and benefit of * * * such other persons as may be interested in such assets" (Sec. 6058, Appendix). The rights of stockholders on the insolvency or dissolution of an insurance corporation are governed in general respects by the rules applicable to stockholders of other kinds of corporations (32 C. J., p. 1039). Upon insolvency or dissolution stockholders of a corporation own the assets of the corporation subject to payment of its creditors (*U. S. v. Butterworth Corporation*, 269 U. S. 504, 70 L. Ed. 380; *Buder v. Stocke*, 343 Mo. 506, 121 S. W. 2d 852.

In 13 Am. Jur., Sec. 1352, p. 1197, it is said:

> "* * * Stated in another way, the rule is that after the dissolution of a corporation, its property passes to its stockholders subject to the payment of the corporate debts."

In *U. S. v. Butterworth Corporation, supra*, this court recognized that stockholders of an insolvent corporation may have an interest in its assets when it said (269 U. S. l. c. 513):

> "* * * It is established that, when a court of equity takes into its possession the assets of an insolvent corporation, it will administer them on the theory that in equity they belong to the creditors and shareholders rather than to the corporation itself."

That the Missouri Insurance Code contemplated that stockholders of an insolvent corporation were interested in the assets of such company has been recognized by the Supreme Court of Missouri in *State ex rel. v. Hall*, 330 Mo. 1107, 52 S. W. 2d 174, 177, wherein that court in speaking of the legislative power of the state to liquidate insurance companies, said:

"The power was first exercised in 1869 by the enactment of an Insurance Code intended to protect policyholders, stockholders, and the public."

It follows therefore by virtue of the elimination of policyholders and other creditors from the classification of *persons interested* in the assets of the dissolved company that these petitioners now constitute the only persons capable of qualifying under the insurance code as "persons interested" in the fund.

V.

Even if the Missouri Insurance Code is not an insolvency law under which claims of creditors may be extinguished, nevertheless, the stockholders, not the policyholders, are entitled to the fund because:

A.

As established in Point III of this argument, when an insurance company has been determined to be insolvent the interests of policyholders are converted by operation of law into claims for money.

B.

Under the Missouri Insurance Code the Superintendent represents and acts for the policyholders in proceedings to liquidate an insolvent insurance company, and his actions are binding upon such policyholders (*Green* v. *American Life & Accident Co.*, 112 S. W. 2d 924 (Mo. App.); *Johnson* v. *American Life & Accident Co.*, 145 S. W. 2d 444 (Mo. App.)). The election of the Superintendent to accept the plan of reinsurance as a method of liquidating and winding up the affairs of the Continental Life Insurance Company was the election of the policyholders to accept said plan. His action was

their action, and they are bound by what he did. The situation therefore is that the policyholders voluntarily accepted the plan of reinsurance, in lieu of the plan of sale of the assets and pro rata distribution of the proceeds, and thereby their claims as creditors of the insolvent company, with their consent, were surrendered in exchange for reinsurance.

C.

Until the policyholders surrendered their money claims for cash surrender values and unearned premiums in exchange for reinsurance they constituted members of the class of *interested persons* qualified under the Code to share in the assets of the insolvent company. Upon their election to accept reinsurance they automatically eliminated themselves from the statutory class of *interested persons* entitled to share in the assets of the insolvent company. The elimination of policyholders and creditors from the class of interested persons therefore leaves only the stockholders qualified as *interested persons* eligible to receive the fund. Elsewhere in this argument it has been demonstrated that stockholders of an insolvent corporation do constitute interested persons under the Missouri Insurance Code.

VI.

Petitioners in the state court asserted a claim under the code to the fund in dispute. The Missouri Supreme Court did not construe or consider said code and, in disregard of it, based its decision upon equitable grounds. In the case of *Broad R. P. Co.* v. *South Carolina*, 281 U. S. 537, 74 L. Ed. 1023, this court said (281 U. S. l. c. 540):

> "Whether the state court has denied to rights asserted under local law the protection which the con-

stitution guarantees is a question upon which the petitioners are entitled to invoke the judgment of this court. Even though the constitutional protection invoked be denied on non-Federal grounds, it is the province of this court to inquire whether the decision of the state court rests upon a fair or substantial basis. If unsubstantial, constitutional obligations may not be thus evaded. *Fox River Paper Co.* v. *Railroad Commission*, 274 U. S. 651, 655, 71 L. Ed. 1279, 1283, 47 Sup. Ct. Rep. 669; *Ward* v. *Love County*, 253 U. S. 17, 22, 64 L. Ed. 751, 758, 40 Sup. Ct. Rep. 419; *Enterprise Irrig. Dist.* v. *Farmers Mut. Canal Co.*, 243 U. S. 157, 164, 61 L. Ed. 644, 648, 37 Sup. Ct. Rep. 318."

In the case of *Lawrence* v. *State Tax Commission*, 286 U. S. 276, 76 L. Ed. 1102, this court was considering a decision of the Mississippi Supreme Court which declined to pass upon the constitutional questions raised but put its decision upon non-Federal propositions, and this court said (286 U. S. l. c. 282):

> "But the Constitution, which guarantees rights and immunities to the citizen, likewise insures to him the privilege of having those rights and immunities judicially declared and protected when such judicial action is properly involved."

Likewise, in the case of *Norris* v. *Alabama*, 294 U. S. 587, 79 L. Ed. 1074, this court said (294 U. S. l. c. 590):

> "When a federal right has been specially set up and claimed in a state court, it is our province to inquire not merely whether it was denied in express terms but also whether it was denied in substance and effect."

Petitioners were entitled to have their rights under the local law determined by the Missouri court. The Missouri Supreme Court arbitrarily evaded a ruling on the local laws involved and placed its decision on what it

termed equitable grounds. Petitioners were therefore denied the protection of the exclusive code of Missouri by an arbitrary refusal to construe the code relied upon by petitioners.

VII.

In the trial court the decision was that the petitioners here did not have the right to intervene in the cause for the purpose of asserting a claim to the fund. Upon appeal from this order to the Supreme Court of Missouri, the latter court did not rule specifically on that question but did consider the claim of petitioners to the fund. In passing on said claim that court did not construe nor apply the insurance code of Missouri under which petitioners asserted a claim. The Supreme Court unexpectedly put its decision upon equitable grounds rather than upon a construction of the applicable Missouri code. When this was done, petitioners filed a motion for rehearing and a motion to modify the opinion, in both of which motions they alleged that the action of the Supreme Court denied them the equal protection of the laws guaranteed to them by the 14th Amendment to the United States Constitution (R. 323, 325). This was a timely injection of the constitutional question because the decision of the court was the thing that first denied petitioners their constitutional rights. One of the exceptions to the general rule that the raising of a constitutional question in a motion for rehearing comes too late is where the grounds of the decision supply a new and unexpected basis for a claim by the defeated party of a denial of a federal right. *Great Northern Railroad Co.* v. *Sunburst Co.*, 287 U. S. 358, 77 L. Ed. 360; *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill*, 281 U. S. 673, 74 L. Ed. 1107.

CONCLUSION.

It is respectfully submitted that petitioners raised the constitutional question at the first opportunity, and that the action of the Supreme Court of Missouri in ignoring the statutes relied upon by petitioners denied petitioners the equal protection of the laws guaranteed to them by the 14th Amendment to the United States Constitution.

Respectfully submitted,

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